



BERMUDA MONETARY AUTHORITY

**GUIDANCE NOTES**

**LARGE EXPOSURES FRAMEWORK  
FOR BERMUDA BANKS AND DEPOSIT  
COMPANIES**

Issued December 2024

**Note:** This document should be read in conjunction with the 'Basel Framework' and Section 38 of the Banks and Deposit Companies Act 1999.

## TABLE OF CONTENTS

I.	ABBREVIATIONS .....	3
II.	INTRODUCTION.....	4
III.	LARGE EXPOSURES (LE) FRAMEWORK.....	5
IV.	EFFECTIVE DATE.....	13
	APPENDIX: CREDIT CONVERSION FACTORS (CCF).....	14

## I. ABBREVIATIONS

The following abbreviations have been used in this document:

BCBS	Basel Committee on Banking Supervision
BDCA	Banks and Deposit Companies Act 1999
BMA	Bermuda Monetary Authority
CCF	Credit Conversion Factor
CCP	Central Counterparty
CRM	Credit Risk Mitigation
LE	Large Exposures
LECB	Large Exposures Capital Base
OTC	Over-the-Counter
PSE	Public Sector Entities
QCCP	Qualifying Central Counterparties
SA-CCR	Standardised Approach for Counterparty Credit Risk
UCC	Unconditionally Cancellable Commitments

## II. INTRODUCTION

1. The Bermuda Monetary Authority (Authority or BMA) recognises the need for banks to measure and limit the size of Large Exposures (LE) in relation to their capital. This measure has long been recognised as a backstop to manage the risk of an institution incurring disproportionately large losses from the default of a single counterparty or group of connected counterparties. Core Principle 19<sup>1</sup> of the Core Principles for Effective Banking Supervision requires that local laws and bank regulations set prudent limits on large exposures to a single borrower or a closely related group of borrowers.
2. An LE framework complements the Authority's risk-based capital framework as the latter is not designed specifically to protect banks from large losses resulting from the sudden default of a single counterparty. In particular, the minimum capital requirements (Pillar 1) of the Authority's risk-based capital framework implicitly assume that a bank holds infinitely granular portfolios (i.e., no form of concentration risk is considered in calculating capital requirements). Contrary to this assumption, idiosyncratic risk due to large exposures to individual counterparties or groups of connected counterparties may be present in banks' portfolios. While the Authority recognises that the Supervisory Review and Evaluation Process (Pillar 2) does allow for the inclusion of a capital add-on for concentration risk, the adjustment looks at all elements of concentration risk and not only single-name concentration. Hence the capital add-on is meant to complement the diversification tools utilised to minimise concentration risk and may not be sufficient to fully mitigate the risk of very large losses from the default of a single counterparty or group of connected counterparties.
3. As part of the Basel III reforms, the Basel Committee on Banking Supervision (BCBS) issued the *Supervisory framework for measuring and controlling large exposures*, a new standard that became effective in 2019<sup>2</sup>. These revisions are partly driven by lessons learned from the 2008 financial crisis, which made it clear that banks did not always consistently measure, aggregate and control exposures to single counterparties or groups of connected counterparties across their books and operations.
4. This Guidance Note replaces the provisions of paragraphs 20 to 34 of *The Management and Control of Credit Risks and the Implementation of the Statutory Provisions for Large Exposures*<sup>3</sup> issued by the Authority in 2007.

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<sup>1</sup> [Principle 19 of the Core principles for effective banking supervision](#)

<sup>2</sup> [Large Exposures framework](#)

<sup>3</sup> [The Management and Control of Credit Risks and the Implementation of the Statutory Provisions for Large Exposures](#)

### III. LARGE EXPOSURES (LE) FRAMEWORK

#### Scope of Application

5. Since the LE Framework is designed to serve as a backstop and complement to risk-based capital standards, it must be applied to a bank on both an unconsolidated and consolidated basis.

#### Definition of Large Exposure Capital Base

6. Large Exposure Capital Base (LECB) is defined as the sum of allowable Tier 1 capital, less any deductions. The LECB for each institution is confirmed by the BMA in writing, at least annually, and must be used as the basis for large exposure reporting until such time as the Authority confirms a change. However, the LECB could be revised prior to these annual submissions in the event that a bank's capital resources significantly change during the interim period.

#### Definition of Exposure Value

7. Banks must consider on-balance sheet and off-balance sheet exposures included in the banking or trading book and instruments with counterparty credit risk under the risk-based capital framework.
8. An exposure to a counterparty that is deducted from capital must not be added to other exposures to that counterparty for the LE limit.<sup>4</sup>
9. Banking book on-balance sheet non-derivative exposures can be measured at either the accounting value of the exposure (net of specific provisions and value adjustments) or on a gross exposure basis.
10. According to the standardised approach for credit risk, the exposure at default must be used as the exposure value for banking and trading book Over-the-Counter (OTC) derivatives (and any other instrument with counterparty credit risk).
11. Off-balance sheet items will be converted into credit exposure equivalents through the use of Credit Conversion Factors (CCF) by applying the CCF set out for the standardised approach to credit risk, with a floor of 10%. The Basel-issued CCF can be found in the Appendix.

#### Definition of Large Exposure

12. A large exposure is exposure to a counterparty or group of connected counterparties that is equal to or greater than 10% of an institution's LECB. An exposure is the maximum loss (in aggregate) that an institution might suffer if a counterparty fails, or a loss that might be experienced in realising any assets or off-balance sheet positions. It therefore includes:

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<sup>4</sup> This general approach does not apply where an exposure is 1,250% risk-weighted. When this is the case, this exposure must be added to any other exposures to the same counterparty. The sum is subject to the LE limit, except if this exposure is specifically exempted for other reasons.

- All claims on a counterparty, including both actual claims and potential claims (e.g., from a drawdown of undrawn, advised facilities or from assets that an institution has committed itself to purchase or underwrite)
- All accrued interest
- Most contingent liabilities

13. The objective is to assess the ‘worst case’ exposure, which means very few items can be excluded when the exposure is calculated. Exposures are reported at their full value and are not scaled down by the risk weights that may apply for capital adequacy purposes. However, claims and other assets already deducted from the institution's capital base for capital adequacy and LE purposes need not be included. This is also the case for counterparty credit risk on futures and options, where the contracts are traded on an exchange and are subject to daily margining requirements, and for bill endorsements on bills already endorsed by another bank.

### **LE Monitoring and Control Framework**

14. The BMA expects banks to implement adequate monitoring and control frameworks for LE. Banks must monitor their overall ‘clustering’ position carefully. This means considering the total of their exposures (excluding short-term inter-bank exposures) equal to, or in excess of, 10% of the LECB as part of their efforts to ensure proper diversification of their risks.

15. The BMA recognises that reporting on LE may on occasion raise particularly sensitive issues regarding client confidentiality in certain jurisdictions. However, the Authority does not expect institutions to encounter problems obtaining the data necessary to monitor and control their large exposures effectively. Where such a concern arises, the Authority must be notified immediately.

16. The Authority expects banks to maintain appropriate LE monitoring and control frameworks designed to ensure that counterparty exposures do not breach the 25% limit. Banks should also ensure compliance with the reporting and pre-approval requirements set out in paragraphs 18 to 20 below.

17. The BMA expects banks to periodically review their large exposure limits against single counterparty exposures to ensure that actual exposures remain within the Authority’s pre-approved limits as well as internal exposure limits set by the respective bank.

18. As part of the LE Framework and for prudent management of large exposures, management information concerning LE is expected to be provided to the board of directors on at least a semi-annual basis. Additionally, any breach of large exposure limits must be reported to the board of directors at the next scheduled board meeting or immediately, depending on the severity of the breach in question.

### **Statutory LE Provisions**

19. Section 38 of the Banks and Deposit Companies Act 1999 (BDCA) places specific LE reporting obligations on banks. The Authority requires institutions to calculate, monitor and report these concentration risks on a ‘worst case’ basis.

20. Banks are required to seek the Authority's prior approval whenever they propose to enter into a transaction or transactions with any one person<sup>5</sup> that would expose them to incurring losses equal to, or in excess of, 25% of their available capital resources in aggregate. The Authority typically only gives consent to exposures in excess of 25% of capital in exceptional circumstances and where the risk of loss can be demonstrated as being extremely small, as per paragraph 23 below.

### **Regulatory Reporting Requirements**

21. Banks must report the exposure values before and after the application of the credit risk mitigation techniques on a quarterly basis. The reporting must include the following:
- a) All exposures with values equal to or above 10% of the bank's LECB; and
  - b) The largest 20 exposures to counterparties, irrespective of the values of these exposures relative to the bank's LECB.

### **Notification of LE Breaches**

22. Institutions must request written approval from the BMA before entering into any commitment to a counterparty or group of connected counterparties that is equal to, or in excess of, 25% of their LECB. Additionally, the Authority would normally expect to be given at least 48 hours' notice in order to ensure that it can respond on a timely basis. Where a case seems likely to raise complex issues, institutions should provide earlier notice. They must also notify the BMA immediately if they become aware of any inadvertent breach of the 25% limit or of other counterparty limits agreed with the Authority for LE purposes. Where institutions fail to identify or report large exposures on a timely basis, the BMA is likely to consider whether the institution continues to meet the minimum licensing criteria. At the same time, such breaches can clearly arise as a result of factors outside an institution's control, such as a merger or takeover among its customers. In such cases, the Authority will agree with an affected institution the remedial action(s) that may be necessary, together with a timetable within which the breach is to be rectified.

### **Lower Risk Exposures**

23. In certain cases where the exposure is likely to involve much lower-than-normal credit risk, the BMA is prepared to approve individual exposures in excess of 25% of LECB. Examples of such exposures may include but are not limited to, exposures of one year or less to licensed deposit-taking institutions, licensed investment firms that are subject to risk-based capital requirements, and exchanges and clearing houses (other than where they are connected to the reporting institution).
24. The BMA stresses that all such exposures remain fully subject to the LE regime, including the obligation to seek pre-approval from the Authority where an exposure equal to, or in excess of 25% of, LECB is contemplated. (In the case of standard inter-bank exposures, consent is generally handled through the Authority's approval of the institution's inter-bank limits.)

25. The BMA will also continue to consider other individual LE if it can be demonstrated that the risk of loss is small. Banks are expected to provide sufficient due diligence along with a large exposure approval request to justify individual exposure requests that are equal to or in excess of 25% of LECB. These requests must be made prior to entering the exposure and submitted in a timely manner to ensure sufficient time for the Authority to review.

### **Connected Counterparties**

26. Connected counterparties include exposures to a group of counterparties with specific relationships or dependencies such that, if one of the counterparties were to fail, there is the likelihood that the other counterparties would as well. A group of this sort is referred to in this framework as a group of connected counterparties and must be treated as a single counterparty.

27. Section 38 of the BDCA requires institutions to take a worst-case approach. This means that exposures to two or more individual counterparties must be treated as exposures to a single counterparty where the persons are connected with each other in such a way that the financial soundness of any of them may affect the financial soundness of the other(s), or if the same factors may affect the financial soundness of all of them. Relationships between individual counterparties likely to give rise to common risks include:

- Entities within the same group
- Entities whose ultimate owner (wholly or significantly) is the same individual or individuals, even without a formal group structure
- Companies having common directors or management
- Counterparties linked by cross guarantees

If a bank is uncertain whether particular counterparties should be treated as constituting a single risk, it should perform an assessment and request the Authority to review and provide guidance.

28. Banks should apply the following criteria to assess the existence of connectedness:

- Control relationship using the criteria set out in paragraphs LEX10.12 to 10.15 of the Basel Framework<sup>6</sup>
- Economic interdependence using the criteria set out in paragraph LEX10.16 of the Basel Framework<sup>7</sup>

29. There are cases where a thorough investigation of economic interdependencies will not be proportionate to the size of the exposures. In such cases, banks are expected to identify possible connected counterparties on the basis of economic interdependence in all cases where the sum of all exposures to one individual counterparty exceeds 5% of Tier 1 capital as set out in paragraph LEX10.18 of the Basel Framework.<sup>8</sup>

30. The BMA may require a bank to aggregate any of its exposures if the Authority believes that such

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<sup>6</sup> [See paragraphs LEX10.11 to 10.15 of the Basel LE Framework](#)

<sup>7</sup> [See paragraphs LEX10.16 of the Basel LE Framework](#)

<sup>8</sup> [See paragraph LEX10.18 of the Basel LE Framework](#)



exposures constitute a common risk.

31. The BMA acknowledges that there may be circumstances where the application of these criteria does not automatically imply an economic dependence that results in two or more counterparties being connected. In instances where a bank undertakes disaggregation of connected counterparties, it should document the rationale for doing so. The documentation should include but is not limited to highlighting where a counterparty, despite being economically closely related to another counterparty, may overcome financial difficulties or default of the latter by finding alternative business partners or funding sources within an appropriate time period.<sup>9</sup>

## **Related Parties**

32. A “related party” is defined as either of the following:

- A party able to exercise control over the institution or over which the institution itself can exert control, together with the institution’s major shareholders, any of its directors, senior management and key staff, as well as close family members of those persons.
- An institution’s subsidiaries and affiliates, together with major shareholders, all directors, senior management and key staff of these entities, as well as close family members of these persons.

To prevent abuses arising out of exposures to related parties, institutions should implement policies and procedures for countering the conflicts of interest and associated risks that may arise. Limits applying to related party exposures must be at least as strict as those applying to non-related counterparties. Institutions need to put in place arrangements for identifying all related parties and establish specific policies and procedures requiring exposures to such persons to be conducted on an arm’s length basis. They must also ensure that these exposures are carefully monitored to prevent abuse, that appropriate steps are taken to control and mitigate risks arising from such exposures and that provisioning and write-off policies are fully consistent with those applying to the generality of exposures.

## **Sovereign Exposures**

33. Exposures to sovereigns and their central banks are exempt from the prior approval requirement: The Authority has issued the “*Basel III for Bermuda Banks – Guidance Notes*” which, under paragraph 81, sets out the risk weights to be assigned to sovereigns and their central banks. Sovereign and central bank exposures that attract a risk weight no higher than 20% are exempted from the prior approval requirement set out in paragraph 20 above.
34. Any portion of an exposure guaranteed by or secured by financial instruments issued by an exempted sovereign would also be exempted from the prior approval requirement.
35. Banks must obtain prior written approval before entering all sovereign exposures not eligible for

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<sup>9</sup> [See paragraph LEX10.17 of the Basel LE Framework](#)

the above exemption where such exposure will be equal to or greater than 25% of the bank's LECB.

36. All exposures to sovereigns must be reported to the Authority if they are equivalent to at least 10% of a bank's LECB.

### **Exposure to Public Sector Entities (PSE)**

37. Exposures to Public Sector Entities (PSE), which retain explicit guarantees from sovereigns that are subject to the above exemption, are also exempted from the prior approval requirement set out in paragraph 20 above. Where explicit guarantees from the relevant sovereign can be evidenced, the exemption set out in paragraph 33 above applies to the relevant PSE, including quangos and any other public body guaranteed by the respective sovereign.
38. Any portion of exposures to PSE guaranteed by or secured by financial instruments issued by sovereigns would similarly be excluded from the prior approval requirement set out in paragraph 20 above provided that the eligibility criteria for recognition of the credit risk mitigation are met.

### **Interbank Exposures**

39. Interbank exposures are subject to the LE Framework. Intraday interbank exposures for daily liquidity purposes are exempted from the LE Framework's pre-approval or reporting requirements to avoid disturbing the payment and settlement processes.

### **Covered Bonds**

40. Paragraph LEX30.37<sup>10</sup> of the Basel LE framework sets out preferential treatment for the exposure measurement of covered bonds that meet certain eligibility criteria that must be satisfied at the inception of the covered bond and throughout its remaining maturity. The BMA has adopted a national discretion to exclude this preferential treatment for covered bonds. The Authority expects banks to look through to the counterparty issuing the cover bond. If the issuing institution meets the requirements of the other specific treatment, then those would apply. Otherwise, standard large exposure treatments for any other type of counterparty must be applied.

### **Collective Investment Undertakings, Securitisation Vehicles and Other Structures**

41. Banks must consider exposures even when a structure exists between the bank and the exposures. This includes scenarios where the bank invests in structures through an entity which itself has exposures to assets (hereafter referred to as the "underlying assets"). Banks must assign the exposure amount (i.e., the amount invested in a particular structure) to specific counterparties following the approach described in paragraphs LEX30.42 to 30.53<sup>11</sup>. Such structures include

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<sup>10</sup> [See paragraph LEX30.37 of the Basel LE Framework](#)

<sup>11</sup> [See paragraphs LEX30.42 to 30.53 of the Basel LE Framework](#)

funds, securitisations, and other structures with underlying assets.<sup>12</sup>

### **Eligible Credit Risk Mitigation Techniques**

42. Eligible Credit Risk Mitigation (CRM) techniques for LE purposes are those that meet the minimum requirements and eligibility criteria for the recognition of unfunded credit protection and financial collateral that qualifies as eligible financial collateral under the standardised approach for credit risk for risk-based capital requirement purposes.
43. The Basel LE framework outlines eligible CRM techniques for the following:
- a) Treatment of maturity mismatches;
  - b) On-balance sheet netting;
  - c) Recognition of CRM techniques in the reduction of original exposures; and
  - d) Recognition of exposures to CRM providers.

### **Trading Book Positions – Calculation of Exposures**

44. Banks must aggregate any exposures to a single counterparty arising in the trading book to any other exposures to that counterparty within their banking book.
45. The Basel LE framework details the following requirements for the calculation of exposure values of trading book positions:
- a) Scope of large exposure limits in the trading book; and
  - b) Calculation of exposure value for trading book positions.
46. Banks must calculate the exposure value for trading book positions in accordance with the criteria set out in paragraphs LEX30.16 to 30.21 of the Basel LE Framework.<sup>13</sup>

### **Offsetting Long and Short Positions in the Trading Book**

47. The Basel LE framework details the treatment for offsetting long and short positions in the trading book, which includes:
- a) Offsetting between long and short positions in the same issue;
  - b) Offsetting between long and short positions in different issues;
  - c) Offsetting short positions in the trading book against long positions in the banking book; and
  - d) Net short positions after offsetting.
48. Banks must offset long and short positions in the trading book in accordance with the criteria set

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<sup>12</sup> [See paragraph LEX30.41 of the Basel LE Framework](#)

<sup>13</sup> [See paragraphs LEX30.16 to 30.21 of the Basel LE Framework](#)

out in paragraphs LEX30.22 to 30.30 of the Basel LE Framework.<sup>14</sup>

### Exposures to Central Counterparties (CCP)

49. Exposures to Qualifying Central Counterparties (QCCP) related to clearing activities are exempted from the prior approval requirements set out in paragraph 20.
50. For non-QCCP, banks must measure their exposure as the sum of both the clearing exposures<sup>15</sup> and non-clearing exposures.<sup>16</sup> Additionally, they must respect the pre-approval requirement set out in paragraph 20 above and the reporting requirements set out in paragraph 21 above.
51. The concept of connected counterparties described in paragraph 26 above does not apply in the context of exposures to CCP that are specifically related to clearing activities.
52. Banks must identify and aggregate all exposures to a CCP related to clearing activities. Exposures related to clearing activities are listed in the table below, together with the exposure value to be used:

Type of exposure	Exposure value
Trade exposures	The exposure value of trade exposures must be calculated using the exposure measures prescribed in other parts of this framework for the respective type of exposures (for instance using the SA-CCR for derivative exposures)
Segregated initial margin	The exposure value is zero
Non-segregated initial margin	The exposure value is the nominal amount of the initial margin posted
Pre-funded default fund contributions	Nominal amount of the funded contribution
Unfunded default fund contributions	The exposure value is zero
Equity stakes	The exposure value is the nominal amount

53. Regarding exposures subject to clearing services (i.e., the bank acting as a clearing member or being a client of a clearing member), the bank must determine the counterparty to which exposures must be assigned by applying the provisions of the risk-based capital requirements.

<sup>14</sup> [See paragraphs LEX30.22 to 30.30 of the Basel LE Framework](#)

<sup>15</sup> [Clearing exposures as defined in paragraph LEX30.57 of the Basel LE Framework](#)

<sup>16</sup> [Non-clearing exposures as defined in paragraph LEX30.59 of the Basel LE Framework](#)

#### IV. EFFECTIVE DATE

54. The revised LE Framework becomes effective on 1 January 2025.

## APPENDIX: CREDIT CONVERSION FACTORS (CCF)

<b>Off-balance sheet exposure</b>	<b>CCF</b>
Unconditionally Cancellable Commitments (UCC)	10%
Short-term self-liquidating trade letters of credit arising from the movement of goods	20%
Commitments, except UCC	40%
NIFs and RUFs, and certain transaction-related contingent items	50%
Direct credit substitutes and other off-balance sheet exposures	100%

